FINANCES OF A CONSERVATION EASEMENT: VALUATION AND COMPENSATION

Introduction

Being committed to conserving the natural systems on one's property does not change that person's financial realities. Only a minority of conservation-minded landowners are able to enter into a conservation easement agreement with no compensation. (though it does happen on a regular basis).

The financial valuation of – and compensation for – the grant of a conservation easement is the formal recognition of those realities. To be clear, it does not provide on-going payments, new revenue streams, or financially-lucrative options to rival the intensive development or fair-market-value sale of a property. It does, however, offset the financial burden a conservation-minded landowner faces when granting a conservation easement.

Compensation for a perpetual conservation easement is not arbitrary – it is a payment for a real property interest, an interest that is assessed and valued by a qualified real property appraiser. But how exactly does this work? What are the valuation methods, and what are the compensation options available to landowners?

This Explainer was created to answer those questions.

THE CONSERVATION EASEMENT EXPLAINER SERIES

This document is part of a series of 'Explainer' documents describing various aspects of the conservation easement tool in plain language.

To see other Conservation Easement Explainers, as well as much more information, go to the: Alberta Conservation Easement Resource Centre

THE CORVUS CENTRE FOR CONSERVATION POLICY

The **Corvus Centre for Conservation Policy** is a Canadian nature-conservation charity based in Calgary, Alberta, Canada

Corvus works with government, NGOs, and others to develop and implement nature-positive policy

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What Creates a Conservation Easement's Value

What Creates the Financial Value in a Conservation Easement?

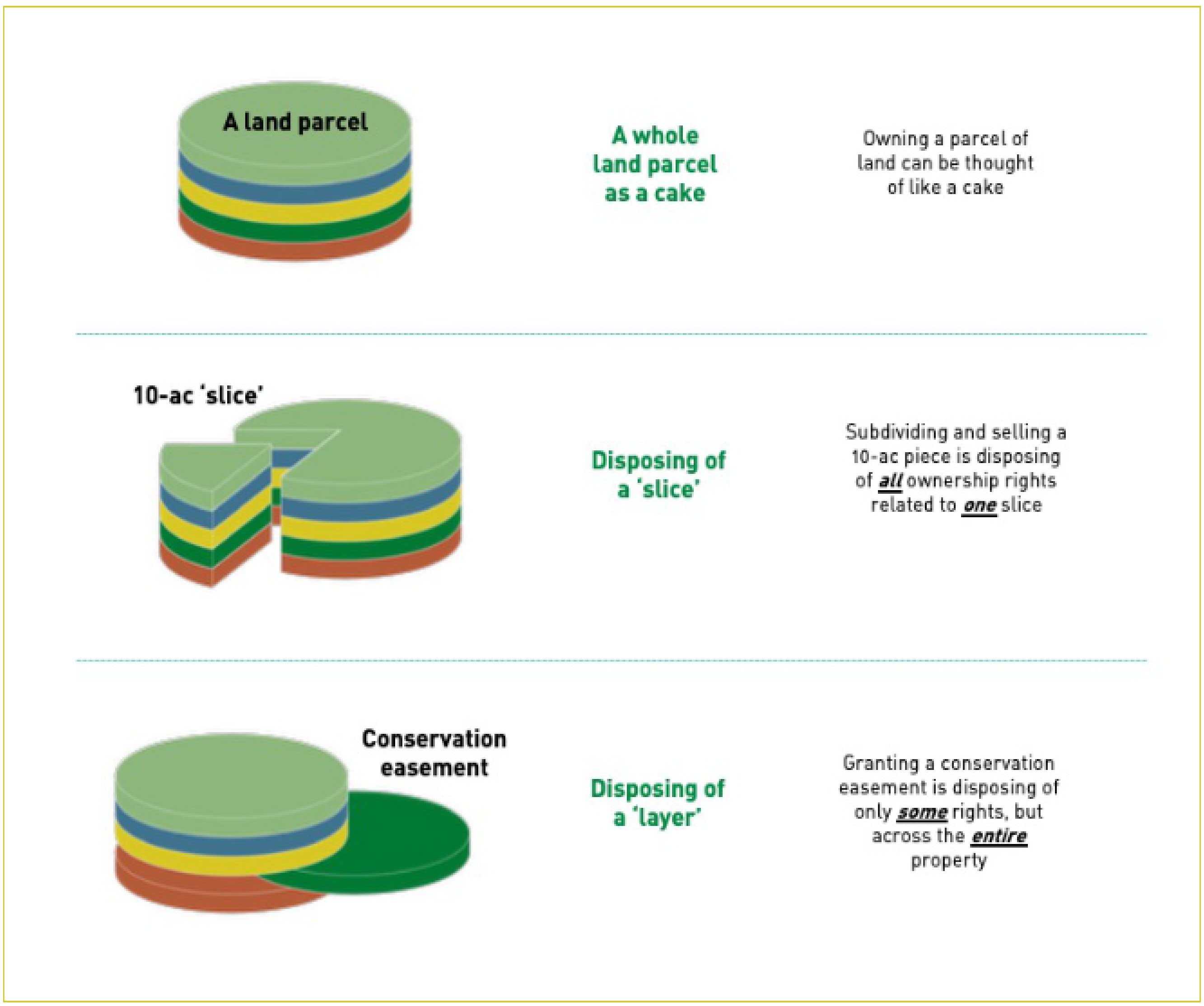
It would be logical to assume that a ***conservation*** easement's financial value would be based on its conservation value; it is not. In fact, the financial valuation is in no way linked to the natural values of the parcel.

Instead, a conservation easement's value is based on the lost "opportunity cost." In other words, it is the dollar-value measure of the impact on a parcel's Fair Market Value (willing buyer and willing seller in an open market) by granting the easement.

A "Disposition of an Interest in Land"

Granting a conservation easement is a "disposition of an interest in land." This is one of the most misunderstood financial aspects of granting a conservation easement, and not because of the legal real estate jargon.

Compensation for the grant of a conservation easement is not a subsidy, payment for services, stewardship bonus, sponsorship payment, environmental reward – it is purely financial compensation for a real estate interest that is assessed (valued) and disposed of (transferred to someone else) in exchange for a cash payment, tax receipt, or combination of the two.



The best way to understand this is to think of land like a cake. Removing a "slice" of the cake is like subdividing (e.g.) 10 acres out of a quarter section, and selling it. That parcel is assessed, valued, and disposed of (transferred) in exchange for a one-time, agreed-upon payment price. A conservation easement operates in exactly the same way, except it is a "layer" of the cake, meaning it affects the entire property, but not all aspects of the property. This "interest" in land is assessed, valued, and disposed of in exchange for a one-time, agreed-upon payment price.

A common question regarding conservation easements is why there is only a "one-time" compensation. That question assumes a conservation easement agreement is some sort of services contract, rather than the disposition of an interest in land. No one would question why a landowner was only paid once for subdividing and selling that 10 acre parcel.

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Comparison to Selling or Developing a Parcel

Prior to conservation easement legislation being adopted by Canadian provinces and territories, private landowners wanting to protect the conservation values of their land had few options. Primarily, they could donate their land to the government to become a park (which many did), or they could donate their land to a conservation charity.

A landowner in these circumstances might also sell their land to a conservation charity, but it was (and still is) difficult for a charity that has no steady revenue streams to generate the resources needed, so these opportunities were few and far between.

Conservation easement legislation created another option – granting away certain rights and opportunities (like the intensive development options), while still holding ownership of the parcel. Even so, the resultant decrease in the value of the land was more than many landowners could accommodate financially.

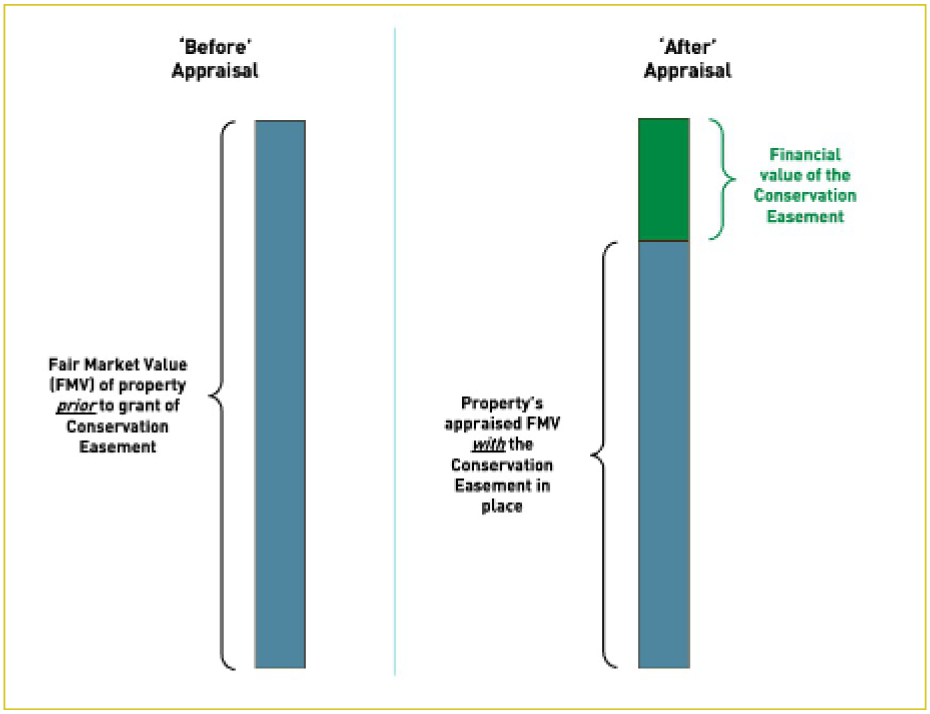
To help offset the financial hit a landowner would take when granting a conservation easement, the financial value of the conservation easement was calculated, and a tax receipt provided as compensation equal to the full value of the lost development potential. Later, it was possible to provide some of that value as a cash payment and some as a tax receipt (see Split Receipts, below).

However, it is important to understand that the grant of a conservation easement is not designed to provide new revenue streams, on-going payments, capital improvements, etc. Selling your land unencumbered or intensively developing it will always be a more financially-lucrative option than granting a conservation easement. Conservation easements are for conservation-minded landowners looking to protect the conservation values of their land, but who need some amount of financial compensation to make that act of conservation feasible.

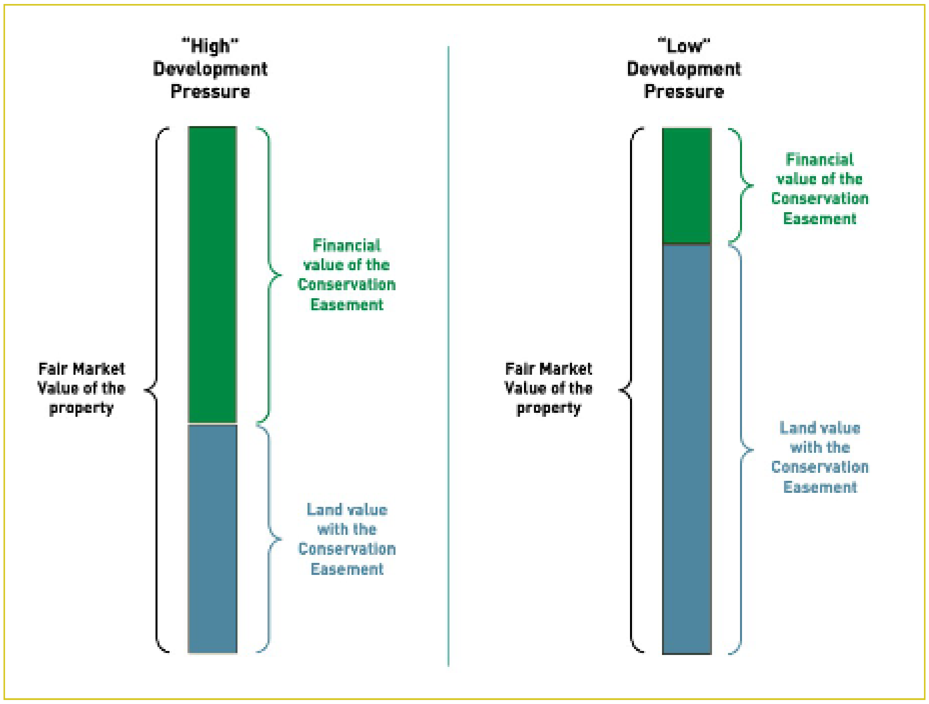
Valuation

Methods

As noted above, a common – and logical – misconception is that a conservation easement's *financial* value is based on its conservation value. Nothing could be further from the truth. The calculation of the financial value of a *conservation* easement is based entirely on a real property assessment and the assumption of a willing buyer and willing seller meeting in an open market.



The most common approach to valuing a conservation easement is the "before and after" method. This approach involves two appraisals – one assuming there is no conservation easement on the property, and the second assuming a specific[1] conservation easement is in place. The two appraisals each assess how the property is likely to be received in the market place; the difference between the two is deemed to be the financial value of the conservation easement.



In most cases, the largest impact on the financial value of a conservation easement is the amount of pressure for development or conversion of the property. Conservation easements generally include restrictions on pursuing subdivision and intensive building activity. If those 'speculative' possibilities make up a large portion of a property's presumed value, the grant of the conservation easement will lower that value significantly. For example, a conservation easement on a parcel near to a large urban centre (i.e., facing significant development speculation) might lower the potential selling price considerably, whereas the 'same' parcel further away from any development pressures might see very little change in potential selling price as a result of a conservation easement. In the latter case, the financial value of the conservation easement would be much lower.

[1] *Because every easement agreement is different, the before-and-after appraisal must consider the actual agreement being applied to the specific parcel.*

Appraisals

As with most legal agreements involving the transfer of real property (or an interest in real property), the financial value of a conservation easement is established through appraisals conducted by qualified real property appraisers. Like any type of property appraisal (art, stamps, airplanes), the appraiser needs to be experienced, in this case in the field of conservation easements.

Appraisals are made using standard real property assessment protocols such as the selling price of 'comparable' properties in the area. However, there are unlikely to be many conservation easement comparables in a given area, so the appraiser needs to be skilled at establishing a basis for the before-and-after method described above. In the case of a conservation easement that is certified as an EcoGift, the appraisal must be done by an appraiser acceptable to Environment and Climate Change Canada, and the appraisal will be reviewed by their panel.

The cost of the appraisal can be significant. That cost may be borne by the landowner, by the easement holder, or shared between the two. Often, conservation easement holders can apply grant dollars to this cost.

Much ink has been spilled on the question of whether a property's value does indeed go down – or up – after the grant of an easement. The reality is that the value goes down at the moment of sale, but its trajectory after that is subject to all the winds and whims of the real property market. For example, an emerging market for 'conservation properties' in a specific area may cause an uptick in the value of a given conservation-easement property.

Regardless, that initial decrease in value is priced in to the future value of the property, meaning all future landowners benefit from a reduced purchase price caused by the removal of certain rights and opportunities at the time the easement is granted.

Valuing Temporary Conservation Easements

Some jurisdictions and organizations are experimenting with temporary conservation easements (often called 'term easements,' though all easements have a term). Valuation of temporary conservation easements is difficult because while both devices use the term 'conservation easement', they are very different.

While a perpetual conservation easement involves the disposition of an interest in land (akin to sale), a temporary conservation easement involves no real property disposition, so cannot use the market-based, real property appraisal methods used in perpetual easements.

In effect the temporary easement seeks to convert that 'sale of an interest in land' of a perpetual easement into a 'regular payment for services.' There is no defined, generally-accepted method for valuing a temporary easement, or establishing the proffered payments.

The most appropriate analogue for valuing a temporary conservation easement is payment for ecosystem services programs, where a price is proposed by the prospective easement holder, and the response of the buyers in that market dictate its acceptability.

Some efforts have been made to value temporary easements as a set percentage of the value of a perpetual easement, but this approach struggles as one is a disposition of an interest in land that can be valued by a real property appraiser, and the other is effectively a services agreement.

Conservation organizations that use temporary conservation easements may offer a set annual payment for the term of the agreement, offer a one-time payment with substantial claw-back provisions for early exit from the agreement, and/or base payment on valuation of the 'ecosystem services' being provided.

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Compensation

Tax Receipt

The vast majority of compensation provided in return for the grant of a conservation easement is in the form of a charitable tax receipt (or 'official donation receipt'). All qualified recipients of a conservation easement are either registered charities, or some level of provincial or municipal government – meaning all are capable of providing charitable tax receipts in exchange for gifts (to better understand the nature of a 'gift' according to the Canada Revenue Agency, see *Donating a Conservation Easement – What Are the Tax Implications? | The Nature of a 'Gift'*).

Donors of a conservation easement are eligible to receive a charitable tax receipt equal to the full appraised value of the easement. This receipt can be used to offset taxes payable in the year of donation, as well as 5 additional years if less than the full receipt is needed to reduce taxes to zero (for EcoGifts, that carryover is an additional 10 years after the year of donation).

Many observers suggest that such tax receipts are unhelpful for people who are "land rich, but cash poor". However, there are many opportunities for such people to creatively use that tax receipt (see Donating a Conservation Easement – What Are the Tax Implications? | Using a Tax Receipt).

Cash Payment

Although they have happened, it is extremely rare for a landowner to receive compensation for the value of a conservation easement entirely in cash. As described above, the originating concept of a conservation easement was to lower the cost of conservation and keep the landowner on the land.

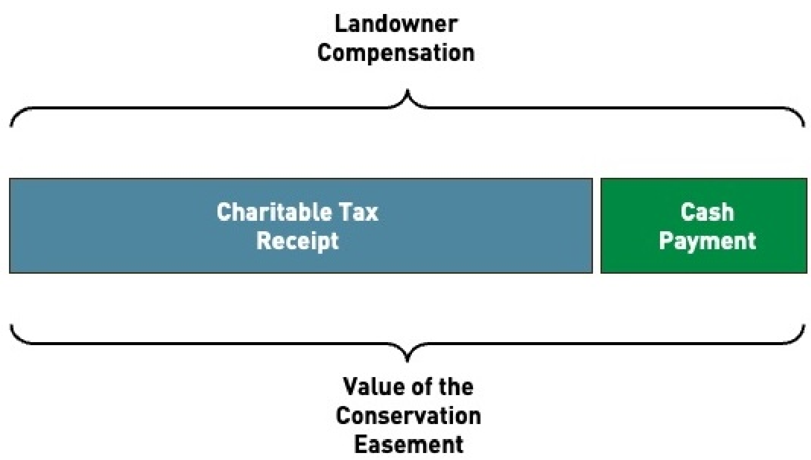
Cash payments made by land conservation organizations can occur when that entity has received grant dollars specifically or has run a public campaign to raise private donations specifically for that purchase. In general, cash payments are made available as part of a 'Split Receipt'.

Split Receipt

Originally, compensation for conservation easements had to be EITHER a cash payment OR a tax receipt. In 2002, a change to Canada Revenue Agency policy introduced the 'Split Receipt' (known as a 'bargain sale' in some jurisdictions). This allowed a person to transfer cash or property to a charity in exchange for a combination of cash and tax receipt equal to the value of the item transferred.

This is now one of the most popular compensation mechanisms for the grant of a conservation easement. It allows the 'donor' of a conservation easement to receive at least some portion of compensation in cash, and can mean the difference between their ability to grant a conservation easement or not.

A 'Split Receipt'



The limit on a Split Receipt is that there can be no more than 80% 'advantage' – meaning that portion of the item transferred which is not a 'gift' (i.e., compensated via a tax receipt) but is paid for (compensated via cash). In practice, the cash portion of a 'split receipt' conservation easement transaction is generally no more than 20% of the value of the easement.

Some organizations will establish a set proportion to be provided in cash (e.g., 20%), regardless of the details of the transaction, in order to establish a standardized model and clear expectations for the landowner.

Subdivision and Development Approvals

In some cases, conservation easements may be granted to municipality by a development proponent in the course of obtaining an approval from that local government.

Municipalities have several land conservation tools they can use, and one of them is the conservation easement, though it may be used in a slightly different fashion from those used by land trusts[2]. As qualified conservation easement recipients, some municipalities have established their own easement programs, wherein they provide a tax receipt in exchange for the donation of a conservation easement.

However, in some cases a development proponent may provide a conservation easement in lieu of some other municipal land conservation mechanism, or as a show of 'additionality' for their proposal. In these cases, the goal is to convince a local government council to approve the subdivision and/or development proposal.

As well, some municipalities have required subdivision proponents to provide a conservation easement as part of an approval. While the enabling conservation easement legislation[3] is silent on whether they can be required in this way, municipalities are granted broad subdivision approval powers by the Municipal Government Act.

Regardless, it is important to note that in neither of these cases is the proponent (i.e., easement grantor) eligible to receive a charitable tax receipt. Because the proponent is receiving something in return (the development approval), the Canada Revenue Agency is unlikely to view the conservation easement as a 'gift' (see Donating a Conservation Easement – What Are the Tax Implications? | The Nature of a 'Gift' for more details).

[2] *'Land trusts' are not-for-profit, charitable organizations with a mandate to hold land or interests in land for conservation purposes.*

[3] *Conservation easements in Alberta are enabled under the Alberta Land Stewardship Act, s28-35*

Frequently asked Questions (FAQ)

Why is the landowner only paid once?
Compensation for a conservation easement is not a payment for repeatable services, it is compensation for the disposition of an interest in land, which occurs only once.

Is a conservation easement's financial value based on its ecological value?
No. The financial value is simply the change in its Fair Market Value as a result of placing the conservation easement on the property.

Can a landowner receive more money than the conservation easement is worth?
Not likely. A charitable tax receipt (and split receipt) cannot exceed the appraised value of the easement. It is exceedingly rare to receive full cash compensation for the fair market value, let alone anything beyond that value.

Who else benefits financially when a landowner grants a conservation easement?
No one. The value of the conservation easement is established, and 100% of the compensation (cash, tax receipt, or split receipt) goes to the landowner granting the easement.

Do municipalities give tax receipts in exchange for a conservation easement?
Yes and no. If the conservation easement is donated freely and without consideration, the municipality can provide a tax receipt; if the easement is provided in order to secure development approval, no tax receipt can be made available.

Who establishes the value of a conservation easement?
The value of a perpetual conservation easement is established by the appraisal conducted by a qualified and experienced real property appraiser. Temporary conservation easements have no standard valuation method.

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